

TESTIMONY OF ROBERT RESTREPO  
BEFORE THE SUBCOMMITTEE ON  
CAPITAL MARKETS, INSURANCE, AND GOV'T SPONSORED ENTERPRISES  
OF THE HOUSE FINANCIAL SERVICES COMMITTEE

JUNE 11, 2002

Thank you Mr. Chairman.

My name is Robert Restrepo, and I am the President and CEO of Allmerica Property and Casualty Companies, located in Worcester, Massachusetts. Our two flagship property/casualty insurance operations are Hanover Insurance Company and Citizens Insurance Company of America.

Allmerica ranks 23rd among all property/casualty insurers in the U.S. Our business, balanced between personal and commercial lines, is written predominantly in the Northeast and Midwest regions of the country. Although Allmerica is not one of the giants of the insurance industry, we are strong supporters of comprehensive insurance regulatory modernization, including optional federal chartering.

I am here today on behalf of the American Insurance Association, which represents over 412 major insurance companies that provide all lines of property and casualty insurance and write more than \$87 billion annually in premiums. I serve as AIA's incoming Chairman, and also participated in the task force that developed AIA's regulatory reform agenda.

I appreciate the opportunity to testify this afternoon about the insurance regulatory system both in the U.S. and abroad and, in particular, AIA's support for optional federal chartering as a way to make the current state regulatory system more effective and efficient for all stakeholders.

Insurance industry mergers and acquisitions, convergence of the various financial services industry sectors, globalization, technology, and, most recently, the tragic terrorist attack of September 11 each have had a tremendous—and very different—impact on our industry. The cumulative effect of these events and changes has been an almost total overhaul of the operating environment in which we conduct business. Yet, the insurance regulatory environment has remained largely unchanged since 1945, when the McCarran-Ferguson Act established the principle of Congressional deference to state insurance regulation. Our industry stands out as one of the most heavily regulated sectors of the U.S. economy, in marked contrast with other financial sectors that are under this Subcommittee's jurisdiction.

For every incremental movement toward greater state regulatory efficiency or uniformity, there are many new state-specific regulatory requirements that result in cost, delay, and frustration for insurers—with minimal, if any, consumer benefit. AIA fully supports continued efforts to modernize and improve the state regulatory system, and we continue to work to that end. However, we also believe that federal regulation is an option that should be made available to insurers and their customers. Regulatory reform, including optional federal chartering, will benefit the insurance mechanism as a whole and, in particular, the individuals, families, and businesses who rely on property/casualty insurance products for short- and long-term financial security. We commend the Subcommittee's focus on this topic as part of your broader examination of insurance regulation in the post-Gramm-Leach-Bliley era.

### The Current State Regulatory System

The current state regulatory system imposes significant costs on insurers and, ultimately, our customers, as well as the economy at large. These costs arise because statutes and regulations are not uniform, and also because, in many states, inefficient and/or inequitable regulatory actions prohibit insurers from appropriately responding to marketplace changes.

While our antiquated regulatory system remains in place—substantially hindering our ability to adapt and better serve our customers—the legal and economic environment in which we operate is changing at breakneck speed. If the insurance industry cannot keep up, the economy suffers because insurance underpins and provides much-needed security for businesses and individuals to innovate, invest, and take on risk. The bottom line is that consumers ultimately will pay more, for less adequate risk protection, than would be the case under a more dynamic regulatory system.

The current state regulatory system is a jumble of individual state requirements. Individual state insurance codes provide dozens of different rate and form regulatory requirements for the various lines insurance. Uncodified practices of many state insurance departments, known as “desk drawer rules,” impose additional, often needlessly onerous, procedural requirements. One problem that this causes in the marketplace is that companies wishing to launch a national product cannot do so until it has been separately approved in every state where they wish to offer the product.

The current fifty-state regulatory system imposes significant direct and indirect costs, including:

- higher compliance costs associated with non-uniform regulations and multiple enforcement requirements;

- complex corporate structures needed to accommodate unique regulatory regimes;
- delayed implementation of new products and pricing changes, due to multi-state regulatory delays; and,
- less competition due to entry, exit, price, and product approval barriers that have been erected in numerous states.

The National Association of Insurance Commissioners (“NAIC”) has acknowledged the need for a more efficient regulatory system. Over two years ago, the NAIC launched a new regulatory modernization effort, dubbing the rate and form regulatory reform project “speed to market.” Indeed, the “speed to market” label aptly describes a key goal of all participants in the regulatory process—to make available new products, at the right price, as quickly as possible.

AIA has been working closely with the NAIC and individual state legislators and regulators to promote speed to market initiatives across the regulatory system as a whole, as well as in each of the states. The NAIC has produced a white paper and, more recently, a model rate and form regulatory reform statute. These recommendations move in the right direction, but ultimately fall short of a true market-based approach. Unfortunately, the pace of change at the state level has lagged even farther behind. Changes that have been made are not uniform. As a result, property/casualty insurers still face a patchwork system of regulatory approvals that imposes significant costs and delays, without concomitant consumer benefits. AIA remains committed to the state reform process, but we urge Congress to move forward with the creation of an optional federal charter.

### International Considerations

Any assessment of the U.S. regulatory system must be done in a global context, given the increased role of insurance in the world economy and the increased number of global insurers. Over the last decade, primarily through the 1997 World Trade Organization (WTO) Uruguay Trade Round, many major insurance markets around the world have undertaken significant reforms in how their markets are regulated, changes that have consistently resulted in more open, modern and competitive regulatory regimes. Countries are embracing these reforms because of their vast benefits to their economies and to provide consumers there with higher levels of consumer choice and service. In fact, the U.S. has encouraged and advocated these reforms in various trade arenas and is in the process now of making significant insurance market-opening requests of all of the 145 member countries of the WTO as a part of the new world Doha Trade Round. These negotiations, expected to be concluded in 2005, are

expected to result in more insurance regulation reforms and market openings in many countries.

While the U.S. should continue to play a leadership role in seeking insurance reforms around the world, it should also address the shortcomings of its own system in an effort to make our system more efficient and competitive. Insurers and consumers alike all over the world will benefit from open and competitive markets that give consumers ready access to needed products at competitive prices. If the U.S. licensing system poses barriers to entry in our market, as some of our trade partners believe (the European Union and Japan specifically), we should address these barriers and seek to make our system as competitive as it can be in this larger global marketplace context. As other countries modernize their regulatory regimes, a failure by the U.S. to modernize our own system will threaten our global competitiveness and reduce our credibility in seeking additional reforms abroad on an ongoing basis.

### Need for an Optional Federal Charter

We believe that optional federal chartering will benefit consumers and boost the competitiveness of the insurance industry. We recognize that you have heard from several witnesses who oppose any federal involvement in the regulation of insurance. However, there are a number of compelling reasons for Congress to move forward with optional federal chartering, including:

*Rapid change has altered all aspects of the insurance mechanism, except its regulatory structure:* Over the past five years, changes stemming from financial services modernization, globalization, and technology have changed the insurance system more dramatically than during the first fifty years since the McCarran-Ferguson Act established the principle of Congressional deference to state insurance regulation. The pace of state-based regulatory improvements has not kept up with the needs of insurers and the customers they serve.

*A level playing field is critical to the long-term viability of the insurance industry:* The Gramm-Leach-Bliley Financial Modernization Act changed the rules of competition for insurers, banks, and securities firms. A level regulatory playing field is essential for insurers who need to compete in this environment. The dual charter (which is similar in concept to optional federal chartering) model has served the needs of banks and their customers for over a century and now deserve serious consideration as an alternative for insurance.

*New technologies do not countenance state-specific regulatory barriers:* The Internet and e-commerce offer tremendous potential for improving the efficiency of the insurance mechanism and increasing customer

awareness and access. However, state-specific regulatory requirements—whether dealing directly with technology or more generally with speed to market for new insurance products—threaten to undermine the ability of insurers, agents, and policyholders to access these technologies fully.

*While some aspects of the insurance industry are local in nature, the business is increasingly national, and international, in its customer focus and regulatory needs:* The insurance industry is extremely diverse. While a state-based regulatory approach may be appropriate for companies that operate on a single-state or regional basis, for national and international companies—as well as their customers—the current fifty-state regulatory system is costly and inflexible. Moreover, the property/casualty insurance industry is not unique in its sensitivity to local conditions, and in many respects, is increasingly national and international in its orientation. Reforms such as optional federal chartering would allow companies, and customers, to choose the regulatory approach that is most suitable for their size and scope of operations.

*Like the industry itself, the challenges facing the property/casualty insurance industry are increasingly national and international in scope:* Terrorism, natural catastrophes, fraud, and asbestos litigation are just some of the major issues facing the property/casualty insurance industry. These issues are complex in scope and far-reaching in their financial implications. Because it is decentralized, the current regulatory system lacks the tools to address these issues in a comprehensive manner. Yet, because of the long history of state regulation, Congress is seen as being reluctant to play an affirmative role in addressing these critical issues.

### Principles for Optional Federal Chartering

Working with other sectors of the financial services industry through the Financial Services Coordinating Council (“FSCC”), AIA has developed a set of principles for an optional federal charter that that would accommodate all lines of insurance. These principles are as follows:

- *Federal insurers and producers and their customers would enjoy the same high level of protection as state chartered insurers and their customers.*
- *Federal insurers and producers, not taxpayers, would be responsible for the ongoing costs of federal supervision and regulation.*
- *The establishment of a federal insurance regulatory authority within the Treasury Department that would be headed by a person appointed by the president and confirmed by the Senate for a fixed term.*

- *This regulatory authority would regulate exclusively federally chartered insurers and producers. State chartered insurers and producers would continue to be regulated by state regulators.*

Taken together, these principles will assure that the new regulatory system is responsive to the needs of customers and claimants, taxpayers, and the public at large. Moreover, they would avoid “competition in laxity,” taxpayer subsidies of the insurance industry, politicization of the regulatory process, dual regulation, and other concerns that have been raised by some of the opponents of optional federal chartering.

Through the FSCC, our organizations also are working to develop a single legislative proposal, which we hope to release shortly. We recognize that this will be a long legislative process, but we look forward to working with you to advance a bill that would result in a safe, sound, and solid new regulatory system.

### Consumer and Public Benefits

Optional federal chartering will bring numerous benefits to consumers and the public at large. For example:

- Consumers should realize savings in insurance costs as the market becomes more efficient, competitive, and the costs of unnecessary regulation are squeezed out of the system.
- Consumers are likely to have more product options, particularly with respect to innovative personal and commercial lines coverages.
- Insurance markets will be able to keep up with fast-paced change in the national and international economies in which their customers operate; at the same time, they will be in a position to satisfy the financial needs of locally based businesses, as well as individuals and families.
- The McCarran-Ferguson antitrust exemption would be removed for insurers which no longer are regulated by the states.
- Optional federal chartering also will enhance the U.S. position as a trading partner and address criticisms from abroad that the current system is protectionist.
- Finally, under optional federal chartering, Congress and the regulators will be well equipped to deal with unexpected national or international crises, such as the September 11 terrorism attack, as well as problems (such as long-tail liabilities) that take some time to develop but nonetheless have

huge financial consequences for the insurance industry and the economy at large. Coordination between federal and state regulators, which has begun since enactment of Gramm-Leach-Bliley, would be greatly enhanced.

### Conclusion

The combination of financial services, modernization, globalization, technology, and the new risk management challenges facing the insurance industry make comprehensive insurance regulatory reform imperative. The regulatory overhaul must include state-based reforms as well as optional federal chartering. This structure will assure a healthy, consumer-oriented U.S. property-casualty insurance for the 21<sup>st</sup> century.

We appreciate the Subcommittee's attention to this important issue, and I would be happy to answer any questions you may have. Thank you.